



JENNIFER M. GRANHOLM
GOVERNOR

STATE OF MICHIGAN
OFFICE OF THE STATE BUDGET
LANSING

ROBERT L. EMERSON
DIRECTOR

January 26, 2007

Michigan State Senate
c/o Ms. Carol Morey-Viventi, Secretary
State Capitol
Lansing, Michigan 48909

Michigan House of Representatives
c/o Mr. Gary Randall, Clerk
State Capitol
Lansing, Michigan 48909

Members of the Legislature:

I am pleased to transmit to you the enclosed unaudited financial statements of the General Fund and School Aid Fund for the fiscal year ended September 30, 2006, as required by Section 18.1493 of the Michigan Compiled Laws. The audited *State of Michigan Comprehensive Annual Financial Report* (SOMCAFR) is scheduled to be available no later than March 2007.

These unaudited financial statements report preliminary unreserved fund balances of \$7.2 million for the General Fund and zero for the School Aid Fund as of September 30, 2006. Please note that these financial statements do not reflect the impact of fiscal year 2006 supplemental appropriations that have been requested by the Office of the State Budget, but not passed by the Legislature. If the requested supplemental appropriations are passed and enacted, the unreserved General Fund balance will be \$5.7 million.

If you have questions regarding the enclosed report, please contact Mike Moody, Director, Office of Financial Management, at (517) 373-1010.

Sincerely,

Robert L. Emerson
State Budget Director

Enclosure

cc: Senate Fiscal Agency
House Fiscal Agency
Mary Lannoye, Executive Office
Tim Hughes, Executive Office

Nancy Duncan, Deputy State Budget Director
Michael Moody, Financial Management
Budget Development Section
Internal State Budget Offices

REPORT TO THE LEGISLATURE
GENERAL FUND AND SCHOOL AID FUND
UNAUDITED FINANCIAL STATEMENTS AND SCHEDULES
FISCAL YEAR ENDED SEPTEMBER 30, 2006

Prepared by:

STATE BUDGET OFFICE
Office of Financial Management

January 26, 2007

**REPORT TO THE LEGISLATURE
GENERAL FUND AND SCHOOL AID FUND
UNAUDITED FINANCIAL STATEMENTS AND SCHEDULES
FISCAL YEAR ENDED SEPTEMBER 30, 2006
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STATE OF MICHIGAN
GENERAL FUND
BALANCE SHEET
 SEPTEMBER 30, 2006
 (In Thousands)
 (Unaudited)

ASSETS

| | |
|--|----------------------------|
| Cash | \$ 6,945 |
| Equity in Common Cash | - |
| Taxes, interest, and penalties receivable (after allowances for estimated uncollectibles of \$ 1,916,104) | 3,130,664 |
| Amounts due from other funds (Note 5) | 540,602 |
| Amounts due from federal agencies | 752,595 |
| Amounts due from local units | 582,285 |
| Inventories | 24,832 |
| Other assets | <u>377,624</u> |
| TOTAL ASSETS | <u>\$ 5,415,548</u> |

LIABILITIES AND FUND BALANCES

Liabilities:

| | |
|--|-------------------------|
| Warrants outstanding | \$ 89,320 |
| Accounts payable and other liabilities | 1,609,637 |
| Income tax refunds payable | 672,394 |
| Amounts due to other funds | 43,131 |
| Deferred revenue | <u>1,926,053</u> |
| Total Liabilities | <u>4,340,534</u> |

Fund Balances:

Reserves for:

| | |
|---------------------------|-------------------------|
| Budgetary carry-forwards: | |
| Encumbrances | 14,852 |
| Restricted revenues | 566,947 |
| Multi-year projects | 30,111 |
| Revolving loan programs | 5,000 |
| Noncurrent assets | <u>450,948</u> |
| Total Reserved | <u>1,067,858</u> |
| Unreserved (Note 3) | <u>7,156</u> |

Total Fund Balances **1,075,014**

TOTAL LIABILITIES AND FUND BALANCES **\$ 5,415,548**

The accompanying notes are an integral part of the financial statements and schedules.

STATE OF MICHIGAN
GENERAL FUND
STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES
FISCAL YEAR ENDED SEPTEMBER 30, 2006
(In Thousands)
(Unaudited)

REVENUES

| | |
|---------------------------------|-------------------|
| Taxes | \$ 11,809,223 |
| From federal agencies | 9,538,417 |
| From local agencies | 105,566 |
| From services | 266,147 |
| From licenses and permits | 275,063 |
| Miscellaneous: | |
| Special Medicaid reimbursements | 93,621 |
| Other miscellaneous | <u>748,242</u> |
| Total Revenues | <u>22,836,279</u> |

EXPENDITURES

| | |
|--|---------------|
| Current by Function: | |
| Conservation, environment, recreation, and agriculture | 343,850 |
| Education | 1,925,200 |
| Family Independence services | 1,491,158 |
| General government | 9,861,386 |
| Health services | 4,337,871 |
| Labor, commerce, and regulatory | 759,205 |
| Public safety and corrections | 2,448,411 |
| Tax expenditures (Note 4) | 834,000 |
| Intergovernmental: local revenue sharing grants | 1,103,625 |
| Capital outlay | <u>48,527</u> |

Total Expenditures 23,153,233

Excess of Revenues over (under) Expenditures (316,955)

OTHER FINANCING SOURCES (USES)

| | |
|--------------------------------------|------------------|
| Capital lease payments | (48,567) |
| Capital lease acquisitions | 123,295 |
| Proceeds from sale of capital assets | 1,339 |
| Transfers from other funds | 256,044 |
| Transfers to other funds | <u>(393,535)</u> |

Total Other Financing Sources (Uses) (61,424)

Excess of Revenues and Other Sources over (under)
Expenditures and Other Uses (378,379)

Fund Balances - Beginning of fiscal year (includes reserves) 1,453,393

Fund Balances - End of fiscal year (includes reserves) \$ 1,075,014

The accompanying notes are an integral part of the financial statements and schedules.

STATE OF MICHIGAN
GENERAL FUND
SCHEDULE OF CHANGES IN UNRESERVED FUND BALANCE
 FISCAL YEAR ENDED SEPTEMBER 30, 2006
 (In Thousands)
 (Unaudited)

| | | |
|--|-------------------|------------------------|
| UNRESERVED FUND BALANCE AT OCTOBER 1, 2005 | | 220,537 |
| FINANCING PROVIDED | | |
| Reserves at October 1, 2005 | \$ 1,232,856 | |
| Revenue and other financing sources for 2005-06 | <u>23,093,662</u> | <u>24,326,518</u> |
| TOTAL FINANCING | | 24,547,054 |
| SPENDING AUTHORIZATIONS 2005-06 | | |
| Appropriations | 9,185,071 | |
| School Aid Fund subsidy | 62,714 | |
| Budgetary adjustments and transfers | 113 | |
| Restricted revenue authorizations | 14,222,499 | |
| Carried forward from 2004-05 | <u>652,700</u> | |
| Gross spending authority 2005-06 | 24,123,097 | |
| Lapsed appropriations | (102,686) | |
| Overexpended appropriations | 68,539 | |
| Reserved for long-term assets | <u>450,948</u> | <u>24,539,899</u> |
| UNRESERVED FUND BALANCE AT SEPTEMBER 30, 2006 | | <u><u>\$ 7,156</u></u> |

The accompanying notes are an integral part of the financial statements and schedules.

STATE OF MICHIGAN
SCHOOL AID FUND
BALANCE SHEET
SEPTEMBER 30, 2006
(In Thousands)
(Unaudited)

ASSETS

| | |
|---|----------------------------|
| Taxes, interest, and penalties receivable (after allowances for estimated uncollectibles of \$ 340,420) | \$ 2,140,499 |
| Amounts due from other funds | 18,017 |
| Amounts due from federal agencies | 51,085 |
| Amounts due from local units | 49,419 |
| TOTAL ASSETS | <u>\$ 2,259,020</u> |

LIABILITIES AND FUND BALANCES

Liabilities:

| | |
|-------------------------------------|-------------------------|
| Warrants outstanding | \$ 650 |
| Accounts payable | 139,365 |
| Amounts due to other funds (Note 5) | 1,737,986 |
| Deferred revenue | 373,669 |
| Total Liabilities | <u>2,251,669</u> |

Fund Balances:

Reserves for:

Budgetary carry-forwards:

| | |
|----------------------------|---------------------|
| Encumbrances | 236 |
| Multi-year projects | 1,270 |
| Noncurrent assets | 5,845 |
| Total Reserved | <u>7,350</u> |
| Unreserved | |
| Total Fund Balances | <u>7,350</u> |

| | |
|--|----------------------------|
| TOTAL LIABILITIES AND FUND BALANCES | <u>\$ 2,259,020</u> |
|--|----------------------------|

The accompanying notes are an integral part of the financial statements and schedules.

STATE OF MICHIGAN
SCHOOL AID FUND
STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES
FISCAL YEAR ENDED SEPTEMBER 30, 2006
(In Thousands)
(Unaudited)

REVENUES

Taxes:

| | |
|-----------------------------------|---------------|
| Sales | \$ 4,831,254 |
| Use | 458,890 |
| Property and real estate transfer | 2,301,207 |
| Tobacco products | 472,199 |
| Personal income | 2,038,983 |
| Miscellaneous taxes | 291,443 |
| From federal agencies | 1,360,742 |
| Miscellaneous | <u>84,914</u> |

| | |
|----------------|-------------------|
| Total Revenues | <u>11,839,632</u> |
|----------------|-------------------|

EXPENDITURES

Current:

| | |
|--|-------------------|
| Grants to or on behalf of school districts | <u>12,636,481</u> |
| Total Expenditures | <u>12,636,481</u> |
| Excess of Revenues over (under) Expenditures | <u>(796,849)</u> |

OTHER FINANCING SOURCES (USES)

Transfers from:

| | |
|--------------------|---------|
| General Fund | 62,714 |
| State Lottery Fund | 688,017 |

Transfers to:

| | |
|----------------------------------|-----------------|
| School Loan Bond Redemption Fund | <u>(44,500)</u> |
|----------------------------------|-----------------|

| | |
|--------------------------------------|----------------|
| Total Other Financing Sources (Uses) | <u>706,231</u> |
|--------------------------------------|----------------|

| | |
|--|----------|
| Excess of Revenues and Other Sources over (under) Expenditures and Other Uses | (90,617) |
|--|----------|

| | |
|--|---------------|
| Fund Balances - Beginning of fiscal year (includes reserves) | <u>97,968</u> |
|--|---------------|

| | |
|--|-----------------|
| Fund Balances - End of fiscal year (includes reserves) | <u>\$ 7,350</u> |
|--|-----------------|

The accompanying notes are an integral part of the financial statements and schedules.

STATE OF MICHIGAN
SCHOOL AID FUND
SCHEDULE OF CHANGES IN UNRESERVED FUND BALANCE
FISCAL YEAR ENDED SEPTEMBER 30, 2006
(In Thousands)
(Unaudited)

| | | |
|--|-------------------|--------------------|
| UNRESERVED FUND BALANCE AT OCTOBER 1, 2005 | | \$ |
| FINANCING PROVIDED | | |
| Reserves at October 1, 2005 | \$ 97,968 | |
| Revenue and other financing sources for 2005-06 | <u>12,590,363</u> | <u>12,688,331</u> |
| TOTAL FINANCING | | 12,688,331 |
| SPENDING AUTHORIZATIONS 2005-06 | | |
| Appropriations | 11,157,415 | |
| Budgetary adjustments and transfers | 23,709 | |
| Restricted revenue authorizations | 1,414,761 | |
| Carried forward from 2004-05 | <u>94,414</u> | |
| Gross spending authority 2005-06 | 12,690,298 | |
| Lapsed appropriations | (7,812) | |
| Reserve for long-term assets | <u>5,845</u> | <u>12,688,331</u> |
| UNRESERVED FUND BALANCE AT SEPTEMBER 30, 2006 | | \$ <u>-</u> |

The accompanying notes are an integral part of the financial statements and schedules.

STATE OF MICHIGAN
NOTES TO FINANCIAL STATEMENTS AND SCHEDULES
FISCAL YEAR ENDED SEPTEMBER 30, 2006
(unaudited)

NOTE 1 – REPORTING ENTITY

These unaudited financial statements and schedules, required by Public Act 431 of 1984, section 493, report the financial position and results of operations of the State of Michigan's General Fund and School Aid Fund for the fiscal year ended September 30, 2006. These funds will be included in the *State of Michigan Comprehensive Annual Financial Report* (SOMCAFR), which has not yet been issued.

The final amounts shown in the audited SOMCAFR may differ from the amounts shown in these unaudited financial statements and schedules due to final adjustments, audit results, and/or subsequent events. While the extent of the adjustments that may be made for the SOMCAFR cannot be accurately projected at this time, these statements were prepared using the best information currently available.

These footnotes relate directly to the General Fund and the School Aid Fund and do not include all disclosures required by generally accepted accounting principles (GAAP). All disclosures required by GAAP will be included in the SOMCAFR.

NOTE 2 – SIGNIFICANT ACCOUNTING POLICIES

Basis of Accounting and Presentation

These financial statements and schedules have been prepared using the modified accrual basis of accounting in accordance with GAAP applicable to general and special revenue funds.

Fund Balance Reservations

Fund balance reservations are used to segregate those funds that are legally restricted or not available for future appropriation. Such reservations include amounts for encumbrances, restricted revenues, multi-year project spending authority carry-overs, and reserves for noncurrent assets. The reserve for "multi-year projects" includes spending authority carried over to fund capital outlay and work projects.

Rounding

The amounts shown in these unaudited financial statements and schedules are reported in thousands and rounded. Therefore, columns and rows may not add to the totals presented.

NOTE 3 – BUDGETARY DISCLOSURES

General Fund Spending Authority Net Lapse

The preliminary General Fund spending authority net lapse for the fiscal year ended September 30, 2006, is \$34.1 million. The following departments had General Fund, General Purpose net overdrafts: Department of Corrections (\$13.9 million), Department of Human Services (\$30.7 million), and Department of State Police (\$3.1 million).

Please note that the preliminary spending authority net lapse figure does not reflect the impact of fiscal year 2006 supplemental appropriations that have been requested by the Office of the State Budget, but not passed by the Legislature. If the requested supplemental appropriations are passed and enacted, the General Fund spending authority net lapse will be \$83.6 million.

Constitutional Requirements

Revenue Limits: Article 9, Section 26, of the State Constitution restricts State revenues to a ceiling that is based upon revenues as a proportion of total personal income for the State. The base year ratio, determined in fiscal year 1979 in relation to calendar year 1977 personal income, is 9.49%. Final calculations determining the State's compliance with this Constitutional provision for fiscal year 2006 will not be completed until after the audited SOMCAFR is issued.

For fiscal year 2005, the most recent year for which final calculations are available, total State revenues subject to this limitation were beneath the constitutional limit by \$4.2 billion. The State expects that total State revenues subject to the limitation will not exceed the limit for fiscal year 2006.

Legislation implementing the Constitutional provision provides that, if total State revenues exceed the limit by less than 1%, the excess may be transferred to the Counter-Cyclical Budget and Economic Stabilization Fund. If such an excess were to equal or exceed 1%, the implementing legislation requires that the entire excess be refunded to payers of the individual income and single business taxes in the fiscal year following the year that the excess was determined and reported.

Local Spending Requirements: Article 9, Section 30, of the State Constitution requires that State spending to, or on behalf of, local units of government shall not fall below a specified percentage of total State spending. The percentage, recalculated effective with fiscal year 1993, is 48.97%.

Final calculations establishing the State's compliance with this Constitutional provision for fiscal year 2006 will not be completed until after the audited SOMCAFR is issued. For fiscal year 2005, the most recent year for which final calculations are available, the proportion of total State spending paid to local units of government was determined to be 59.4%, reflecting payments that exceeded the minimum required by \$2.7 billion. The State expects that payments to local units of government will exceed the minimum requirement for fiscal year 2006.

STATE OF MICHIGAN
NOTES TO FINANCIAL STATEMENTS AND SCHEDULES
 FISCAL YEAR ENDED SEPTEMBER 30, 2006
 (unaudited)

Budget Stabilization Fund

The Counter-Cyclical Budget and Economic Stabilization Fund ("Budget Stabilization Fund") was created by Public Act 76 of 1977 to assist in stabilizing revenue during periods of economic recession. In general, the law requires payments into the fund when real economic growth exceeds 2% and allows withdrawals from the fund when real economic growth is less than 0%. Funds can also be withdrawn when the State's unemployment rate exceeds 8% or upon appropriation to finance capital outlay or other projects, or for other purposes designated by the Legislature.

The following table summarizes the preliminary results of transactions for the fund for fiscal year 2006 (in millions):

| | |
|-----------------------------------|---------------|
| Beginning unreserved fund balance | \$ 2.0 |
| Interest income | <u>.1</u> |
| Ending unreserved fund balance | <u>\$ 2.0</u> |

School Aid Fund Budgetary Provisions

The School Aid Fund receives State revenues restricted to local school programs, including constitutionally dedicated sales tax revenues; Lottery Fund earnings; and portions of the personal income, tobacco products, liquor, and industrial and commercial facilities taxes. In addition, all property tax (referred to as the "education tax"), is deposited directly to the School Aid Fund. School aid payments are made based upon a statutory formula.

The ending unreserved fund balance in the School Aid Fund is legally available only to finance future appropriations for K-12 public education purposes.

NOTE 4 – TAX EXPENDITURES

Tax expenditures are reported for those individual income tax credits which are paid even if they exceed the individual's tax liability. The State considers these refundable tax credits to be grant payments administered using the State's income tax system as a filing and payment mechanism. Total tax expenditures in fiscal year 2006 were \$834.0 million, the largest components of which were \$459.1 million for the General Homestead Property Tax Credit and \$306.3 million for the Senior Citizens Property Tax Credit.

NOTE 5 – FINANCIAL STATEMENT PRESENTATION OF CASH DEFICITS

The year-end cash deficit in the School Aid Fund is reclassified as a liability (\$1.7 billion at September 30, 2006), to the General Fund and the Special Revenue Funds that are providing common cash borrowing at fiscal year-end. These reclassification entries are made only at year-end for reporting purposes and do not impact the amount of interest distributed (or paid) by the respective funds.

NOTE 6 – CONTINGENCIES

The State is party to various legal proceedings seeking damages or judgments against the State. Also, federally funded programs are subject to audits which could result in future repayments of recognized revenues. The ultimate disposition of such contingencies cannot presently be determined; however, in some cases estimated amounts have been recorded. Before the final SOMCAFR is issued, some of the amounts recorded as estimated liabilities will change because improved estimates are available or the status of a contingency has changed.